FISCAL NOTE

Bill #:	HB0741	**Title:**	Retail sales tax and use tax on sale of goods and services
Primary Sponsor:	Peterson, J	**Status:**	As Amended in House Committee

Sponsor signature Date   David Ewer, Budget Director Date

Fiscal Summary

	FY 2006 Difference	FY 2007 Difference
Expenditures:		
General Fund	$9,998,896	$132,791,543
Revenue:		
General Fund	$222,735,011	$246,252,560
State Special Revenue	$739,211	($9,365,649)
Net Impact on General Fund Balance:	$212,736,115	$113,461,017

☒	Significant Local Gov. Impact	☒	Technical Concerns
☐	Included in the Executive Budget	☒	Significant Long-Term Impacts
☐	Dedicated Revenue Form Attached	☒	Needs to be included in HB 2

Fiscal Analysis

ASSUMPTIONS:

1. This bill would
   a. impose a general sales tax with revenue dedicated to BASE school funding and the university system with any excess allocate to the general fund;
   b. fund the school district general fund BASE budgets with sales tax revenue
   c. eliminate the statewide school and university mill levies and local BASE budget mill levies;
   d. revise the individual income tax to have a single rate, a higher personal exemption, and no deduction for federal taxes;
   e. exempt half of capital gains from individual or corporate income tax;
   f. provide a refundable low income credit against income tax, and
   g. eliminate the allocation of oil and natural gas tax to the university system.

Sales Tax

2. Beginning January 1, 2006, this bill would impose a 4% sales and use tax on retail sales of tangible personal property and e following exemptions: sales by or to a government or tribe; educational services; radio and television broadcasting to the extent tax is prohibited by federal law; transportation except for

unscheduled air passenger transportation, surface passenger transportation other than transit, and school and employee transportation; advertising services and products; services by an employee for the employee's employer; insurance commissions and premiums; rental or lease of a motor vehicle for more than 30 days; services a corporation provides to an affiliate or subsidiary that is centrally assessed; gambling; unprepared food; prepared food that is part of a residential or health care arrangement; sales of utility services; telecommunications services subject to the retail telecommunications excise tax; medicine, durable medical equipment, mobility enhancing equipment and therapeutic and prosthetic devices; health services and services reasonably related to the delivery of a health service; motor fuels; sale, rent or lease of a vehicle not rated as a light vehicle or with a manufacturer's rated capacity over 1 ton, except for motor homes; half of the initial sale of a motor home; dividends and interest; commissions and fees for brokerage services; sales to and uses by individuals engaged in agricultural, forestry, fishing and hunting of products consumer or integral to the process; non-retail sales by individuals engaged in agricultural, forestry, fishing and hunting; sales or lease of mineral interests; minerals or chemicals used in processing ores; inputs used in construction, mining, manufacturing, rail transportation, electrical generation, and telecommunications which are integral or consumed in the process; sales of real property and improvements; half the value of the initial sale of a mobile or manufactured home; rent or lease of a dwelling; advertising; interstate sales to the extent tax is prohibited by federal law; and sales for resale or lease.

3. During the six months of FY 2006 when the sales tax would be in effect, taxable sales would be $6,180.054 million, and tax liability would be $247.202 million. In FY 2007, taxable sales would be $12,852.206 million, and tax liability would be $514.088 million. To control for noncompliance, it is assumed that vendors would remit taxes equal to 95% of tax liability. This reduces collections by $12.360 million in FY 2006, and by $25.704 million in FY 2007.
4. There would be approximately 55,000 businesses collecting the tax on their sales. The bill provides for a vendor allowance. Total vendor allowances would be $3.626 million in FY 2006 and $7.318 million in FY 2007.
5. Taxes collected by vendors, less vendor allowances, would be paid to the state. Net sales and use tax collections, before sales tax administration costs, would be $231.216 million in FY 2006 and $481.066 million in FY 2007. Sales tax revenue would be deposited in the state general fund.
6. Under current law, rental vehicles and accommodations are subject to a sales tax with rates of 4% and 3%, respectively, with revenue going to the general fund. This bill would incorporate these existing taxes in the general sales tax, raising the rate on accommodations to the general 4% rate, and allocating all revenue to the sales tax account. Current law sales tax collections in FY 2006 are projected to be $2.704 million from rental vehicles and $10.715 million from accommodations. In FY 2007, collections are projected to be $2.820 million from rental vehicles and $11.419 million from accommodations. This change would reduce general fund revenue by $13.419 million in FY 2006 and by $14.239 million in FY 2006.

Individual Income Tax

7. This bill would reduce individual income tax liability beginning with tax year 2007. This would impact FY 2007 revenue to the extent that state withholding tables are adjusted to take these changes into account and to the extent that taxpayers adjust estimated payments to reflect the tax changes.
8. Under current law, individual income taxpayers are subject to marginal tax rates that range from 1% to 6.9%; are allowed to deduct up to $5,000 ($10,000 if married and filing jointly) of federal income taxes paid during the tax year; and are allowed a tax credit equal to 2% of capital gains income.
9. This proposal would provide for a single income tax rate of 5.75%; eliminate the deduction for federal income taxes paid; repeal the capital gains tax credit; and exclude 50% of capital gains from taxable

income. In addition, the personal exemption amount for the taxpayer and the taxpayer's spouse and dependents is increased from a forecast $1,960 to $5,990 beginning with tax year 2007.

10. These changes are estimated to reduced tax liabilities of all filers by $71.790 million in tax year 2007 and by $79.536 million in tax year 2008. State general fund collections would be reduced by $37.940 million in FY 2007 and $76.915 million in FY 2008.
11. In addition, eliminating the 101 state mills and local mill levies associated with the BASE portion of school funding for tax year 2006 (FY 2007), will reduce deductions for property taxes. This will increase state income tax liabilities for full-year residents by $2.784 million in FY 2007 and $2.800 million in FY 2008.
12. Sections 48-52 provide for a refundable credit against individual income taxes to offset sales taxes paid by low-income Montana households. This credit is equal to a specified dollar amount for each person in the household that qualifies for a personal exemption for income tax purposes for the taxpayer and the spouse and dependent children of the taxpayer, according to the following schedule:

HB741 Sales Tax Credit
Amount per Exemption, by Income Bracket

Household Income	Credit Amount per Exemption
Up to $10,000	$90
$10,000 - $12,000	$80
$12,000 - $14,000	$70
$14,000 - $16,000	$60
$16,000 - $18,000	$50
$18,000 - $20,000	$40
$20,000 - $25,000	$30
$25,000 - $30,000	$25
$30,000+	$0

Both the sales tax and this credit would apply beginning January 1, 2006. There would be a full year's worth of credits claimed on 2006 individual income tax returns filed in FY 2007.

13. Based on an analysis of eligible households from the individual income tax database, and adjusting for households that do not file individual income tax returns, it is estimated that this credit would reduce individual income tax collections (state general fund revenue) by approximately $25 million annually, beginning in FY 2007.
14. The net effect of these changes would reduce general fund revenue by $60.156 million in FY 2007 and $99.115 million in FY 2008.

Corporation License Tax

15. Section 76 of the bill, amending 15-31-114, MCA, provides that corporations will be allowed to deduct 50% of the total net capital gains determined for federal income tax purposes when determining Montana corporation license tax liabilities. This section applies to tax years beginning after December 31, 2006 (tax year 2007 and thereafter). There is no impact from this provisions to general fund revenues in the 2007 biennium. However, allowing this deduction will act to reduce revenues to the state general fund beginning in FY 2008 and all subsequent fiscal years. The magnitude of this impact has not been estimated, but could be significant.

Property Tax

16. This bill repeals the 95 mills levied for the state general fund and the 6 mills levied for the university account beginning January 1, 2006. With the exception of non-levy revenue received from federal forest

reserves, all other non-levy revenue associated with these mills will accrue to other local government and school district accounts in proportion to the mills levied for those accounts.

17. Most property taxes are paid in November and May of the fiscal year following assessment. However, under the provisions of 15-16-119, MCA, owners of personal property that is not-liened to real property pay property taxes 30-days after assessments are mailed. This means that instead of paying taxes in November and May of the following fiscal year, they will pay sometime before April in the current fiscal year. Therefore, there are some FY 2006 impacts associated with the bill.
18. About 38% of personal property is identified as “personal property not liened to real property”. In FY 2006, estimated taxable value loss associated with this property is $47,631,468. In FY 2007, the entire amount of taxable value ($1,852,941,477), and associated mill levy revenue would no longer be assessed for state purposes.
19. Estimated mill levy property tax loss to the general fund is estimated to be $4,524,989 ($47,631,468 x 95.0 mills) in FY 2006, and $176,029,440 ($1,852,941,477 x 95.0 mills) in FY 2007.
20. Estimated mill levy property tax loss to the university 6 mill account is estimated to be $285,789 ($47,631,468 x 6 mills) in FY 2006, and $11,117,649 ($1,852,941,477 x 6 mills) in FY 2007.
21. In addition to mill levy revenue loss; with the exception of non-levy revenue received from federal forest reserves, all other non-levy revenue associated with these mills will accrue to other local government and school district accounts in proportion to the mills levied for those accounts. This is estimated to reduce revenues to the state general fund by an additional $3,755,000 in FY 2007.
22. Non-levy revenues to the 6-mill university system account are reduced by an estimated $300,000 in FY 2007.
23. Section 79 of the bill, amends 17-3-231, MCA, allowing the state to keep a proportional amount of federal forest reserve payments equal to 55 mills to the total mills levied. This is different than under current law because without the state 95 mill levy, the overall mill levy is lower, which raises the proportional amount that 55 mills will receive. It is estimated that this would be a net *gain* to the general fund of approximately $440,000 in FY 2007.
24. Total property tax revenue *loss* to the general fund as a result of this bill is estimated at $4,524,989 for FY 2006, and $179,344,440 ($176,029,440 + $3,755,000 - $440,000) for FY 2007.
25. Total property tax revenue *loss* to the 6-mill university system account is estimated at $285,789 for FY 2006, and $11,417,649 ($11,117,649 + $300,000) for FY 2007.
26. General fund property tax revenue into FY 2008 and succeeding years is expected to increase by 3.2% annually. With a growth rate of 3.2%, the general fund would lose $185,083,462 ($179,344,440 x 103.2%) in FY 2008.
27. Assuming the same 3.2% growth rate into the future, the university 6-mill account would lose an estimated $11,783,014 ($11,417,649 x 103.2%) in FY 2008.

Oil and Natural Gas Production Tax

28. This bill amends 15-36-331, MCA to reduce the county share of oil and natural gas production revenue distributions by approximately 33%. These revenues will instead go to increase the state portion and are distributed in the same manner as under current law as shown in the following table:

HB 741 Impact on Distribution of Oil and Gas Production Tax Revenues (million)

Fund	Current Law	HB 741	FY 2006 Impact	FY 2007 Impact
Board of Oil & Gas Conservation	$3.993	$3.993	$0.000	$0.000
County Governments	$32.465	$36.791	$0.000	$4.326
Countywide School Funds	$7.343	$0.000	$0.000	($7.343)
School Districts	$27.948	$9.987	$0.000	($17.961)
Coal Bed Methane Protection Account	$0.807	$1.065	$0.129	$0.258
Reclamation & Development Grants SRA	$1.935	$2.554	$0.309	$0.619
Orphan Share Account	$1.935	$2.554	$0.309	$0.619
State University System SRA	$1.738	$2.294	$0.278	$0.556
State General Fund	$59.182	$78.108	$9.463	$18.926

Revenue Summary

29. The following table shows all revenue impacts:

	FY 2006	FY 2007
General Fund		
Sales Tax	$231,216,000	$481,066,000
Car Rental and Accommodations Taxes	($13,419,000)	($14,239,000)
Income Tax	-	($60,156,000)
Corporate License Tax	-	-
Property Tax	($4,524,989)	($179,344,440)
Oil and Gas Production Tax	$9,463,000	$18,926,000
Total	$222,735,011	$246,252,560
University System 6 mill account		
Property Tax	($285,789)	($11,417,649)
Oil and Gas Production Tax	$278,000	$556,000
Total	($7,789)	($10,861,649)
Coal Bed Methane Acct (Oil & Gas Tax)	$129,000	$258,000
Reclamation & Development Grants Acct (Oil & Gas)	$309,000	$619,000
Orphan Share Account (Oil & Gas Tax)	$309,000	$619,000

School Funding

30. Beginning in FY 2007, oil and gas revenue would not be distributed to the county retirement funds. Under current law, the county retirement funds are anticipated to receive $5.905 million. The average marginal costs of state guaranteed tax base aid payment to counties is 27%. The increased state general fund expenditure is anticipated to be $1.594 million.

31. Under current law, direct state aid to school districts funds 44.7% of the basic and per-ANB entitlement. Beginning in FY 2007, direct state aid would fund 80% of the basic and per-ANB entitlement and 40% of the special education allowable cost payment.
32. Beginning in FY 2007, this bill would eliminate local property tax levies for BASE funding, which would eliminate state guaranteed tax bas aid for base funding.
33. This bill eliminates state block grants to school districts in section 20-9-630, MCA, beginning in FY 2007.
34. School districts will use the following sources of revenue to fund the over BASE budget and offset local over BASE mills so that they will not be available to fund the BASE budget:
    a. Fund balance reappropriated
    b. Interest earned
    c. Coal Gross Proceeds
35. The changes to general fund expenditures for schools in FY 2007 are as follows:

Increased GTB for county retirement	$1,594,000
40% special education funding	$14,579,384
Block Grants to Districts	($50,594,815)
Direct State Aid	$251,062,964
Guaranteed Tax Base Aid for BASE levies	($100,165,495)
Total	$116,476,038

Montana University System

36. Property tax revenue to the university system university six-mill account would be reduced (assumption 25) while oil and gas tax revenue to the account would be increased (assumption 28). The university system would be given a statutory appropriation of $11.9 million in FY 2007. This appropriation would grow each year at the rate of growth of statewide taxable value for property tax purposes. The funding changes to the university system would be as follows:

	FY 2006	FY 2007
Six mill levy	($285,789)	($11,417,649)
Oil and Gas Tax	$278,000	$556,000
Total	($7,789)	($10,861,649)
General Fund Appropriation	$0	$11,900,0000
Net to University system	($7,789)	$1,038,351

Tax Administration

37. The Department of Revenue would require an additional 78 FTE in FY 2006 and 99 FTE in FY 2007 to implement this tax. As shown below, total costs would be $9,987,611 in FY 2006 and $4,415,505 in FY 2007.
38. This bill does not change the Department of Revenue's responsibilities or costs for administering the income, property, and oil and gas taxes.
39. Persons registering motor vehicles, boats, snowmobiles, off-highway vehicles, and aircraft would be required to show evidence that they had paid sales tax or pay the tax at the time of registration. To implement this requirement, the Department of Justice would have one-time start-up operating costs of $11,285 for computer programming, requirements analysis and design, testing and implementation (and estimated 92 hours) and computer time usage (13 days).

FISCAL IMPACT:

	FY 2006 Difference	FY 2007 Difference
Department of Revenue		
FTE	78.00	99.00
Expenditures:		
Personal Services	$2,669,620	$3,452,640
Operating Expenses- FTE	779,791	761,065
Contract for IT modifications	6,000,000	0
Equipment	538,200	201,800
TOTAL	$9,987,611	$4,415,505
Funding of Expenditures:		
General Fund (01)	$9,987,611	$4,415,505
Revenues:		
General Fund (01)	$222,735,011	$246,252,560
State Special Revenue (02)		
University System 6 mill account	($7,780)	($10,861,649)
Coal Bed Methane account	$129,000	$258,000
Reclamation & Development Grants account	$309,000	$619,000
Orphan Share account	$309,000	$619,000
Department of Justice		
Expenditures:		
Operating Expenses	$11,285	$0
Funding of Expenditures:		
General Fund (01)	$11,285	$0
Office of Public Instruction		
Expenditures:		
Local Assistance	$0	$116,476,038
Funding of Expenditures:		
General Fund (01)	$0	$116,476,038
Montana University System		
Expenditures:		
Transfers	$0	$11,900,000
Funding of Expenditures:		
General Fund (01)	$0	$11,900,000

Summary

FTE	78.00	99.00
Expenditures:		
Personal Services	$2,669,620	$3,452,640
Operating Expenses	$6,791,076	761,065
Equipment	$538,200	201,800
Transfers	$0	$128,376,038
TOTAL	$9,998,896	$132,791,543
Funding of Expenditures:		
General Fund (01)	$9,998,896	$132,791,543
Revenues:		
General Fund (01)	$222,735,011	$246,252,560
State Special Revenue (02)		
University System 6 mill account	($7,780)	($10,861,649)
Coal Bed Methane account	$129,000	$258,000
Reclamation & Development Grants account	$309,000	$619,000
Orphan Share account	$309,000	$619,000
TOTAL	$223,474,222	$236,886,911
Net Impact to Fund Balance (Revenue minus Funding of Expenditures):		
General Fund (01)	$212,736,115	$113,461,017
State Special Revenue (02)		
University System 6 mill account	($7,780)	($10,861,649)
Coal Bed Methane account	$129,000	$258,000
Reclamation & Development Grants account	$309,000	$619,000
Orphan Share account	$309,000	$619,000

EFFECT ON COUNTY OR OTHER LOCAL REVENUES OR EXPENDITURES:

Local governments and school districts will receive an additional $8.543 million in non-levy revenues in FY 2007 and thereafter, from repealing the 95 mills levied for state general fund purposes.

Repealing the 95 mills levied statewide for state government purposes will reduce the amount of revenue accruing to tax increment financing districts across the state by about $3.2 million, annually. This may impact some TIF districts' ability to service their bonding obligations without other appropriate local government action.

Local property tax mill levies will be reduced by the number of mills that otherwise would be levied to support the BASE portion of school district general fund budgets under current law.

Local governments and school districts would receive about $21 million less each year in oil and gas production tax.

LONG-RANGE IMPACTS:
FY 2008 would be the first year when the full impacts of this bill would be felt Sales tax revenue will be $510 million, and additional oil and gas production tax revenue to the general fund would be $18.9 million. Reductions to general fund revenue would be $15.0 million from accommodations and rental car taxes, $99 million from income tax, $185 million from property tax, and an unknown amount from corporation license tax. The net increase in general fund revenue would be somewhat less than $230 million, depending on the size of the loss in corporation license tax.

The university system 6 mill account would receive $11.8 million less in property tax and $0.6 million more in oil and gas tax for a net reduction of $11.2 million. The coal bed methane protection account would receive about $0.3 million in additional oil and gas tax, and the reclamation and development grants account and the orphan share account each would receive about $0.6 million in additional oil and gas tax.

Additional general fund expenditures would be about $117 million for schools, $12.3 million for the university system, and $4.2 million for tax administration. Additional general fund revenue would be almost $100 million more than additional general fund expenditures.

TECHNICAL NOTES:

Taxes
1. Insects for biological control are not included in the definition of agricultural production unlike a similar definition provided in 15-1-101, MCA.
2. Section 1(17) provides a definition of "engaging in business" which differs from the current definition in 15-31-101, MCA.
3. Section 1(38)(a) defines sales price as being without any deduction for credit for trade-in, while section 1(38)(c) states that sales price does not include the trade-in value of tangible personal property when the trade-in and purchase occur in one transaction. These provision appear to conflict.
4. Section 6 discusses direct payments. However, the term "direct payment" is not defined.
5. Section 9 provides for government agency exemptions for all products and services. Under current law, government agencies are subject to the rental vehicle and lodging facilities tax.
6. Section 13(4) provides an exemption for any service "reasonably related" to the delivery of a health service. The term "reasonably related" needs additional clarification.
7. Section 16 indicates the premiums of an insurance company are exempt. It might be better to state the premiums "paid to" an insurance company are exempt.
8. Sections 29 through 32 provide seller registration requirements. However, no penalty is imposed for failure to register.

School Funding
9. HB 741 moves approximately $10 million from BASE budgets, where funding is equalized, to the above BASE portion of district general fund budgets, where funding is not equalized. These sources of revenue are not evenly distributed across the state and may lead to an erosion of the equity in funding between school districts. These sources of revenue include:
    a. Interest earned
    b. Oil and Gas Revenue
    c. Coal Gross Proceeds
    d. State Block grants to districts contained in MCA sections 15-1-111, and 15-1-112.

10. Sections 89 and 93 have conflicting language. Section 89 appears to eliminate the requirement for a district levy to fund one-half of the BASE budget for a nonisolated elementary district. Section 93 still refers to the BASE budget levy for a nonisolated elementary district.
11. Section 98 amends the payment schedule for the distribution of BASE aid by eliminating the schedule for distributing all GTB aid. The GTB aid for retirement is currently distributed to counties in November and May and should be continued on that schedule.
12. Section 99 should be restored to its current law version because guaranteed tax base aid for retirement still exists.